



Legislative Bulletin.....April 18, 2007

Contents:

H.R. 1257—Shareholder Vote on Executive Compensation Act

Summary of the Bills Under Consideration Today:

Total Number of New Government Programs: 0

Total Cost of Discretionary Authorizations: \$3 million over five years

Effect on Revenue: \$0

Total Change in Mandatory Spending: \$0

Total New State & Local Government Mandates: 0

Total New Private Sector Mandates: 2

Number of Bills Without Committee Reports: 0

Number of Reported Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

H.R. 1257—Shareholder Vote on Executive Compensation Act (Rep. Frank, D-MA)

Order of Business: The bill is scheduled to be considered on Wednesday, April 18th, subject to a modified open rule, making in order only those germane amendments pre-filed in the *Congressional Record* by the close of business on April 17, 2007. The RSC will summarize pre-filed amendments in a separate document.

Summary: H.R. 1257 would amend the Securities Exchange Act of 1934 (15 U.S.C. 78n) to require that shareholders of public companies be given an advisory vote on the compensation of company executives.

Specifically, the bill would require that any proxy, consent, or authorization for an annual or other shareholders meeting occurring on or after January 1, 2009, permit a separate shareholder vote to approve the compensation of executives (as disclosed pursuant to the Securities and Exchange Commission's—SEC—compensation disclosure rules). The shareholder vote would not be binding on the board of directors and could not be construed as overruling a decision by such board, or as creating or implying any additional fiduciary duty by the board. Furthermore, the vote could not be construed as restricting or limiting the ability of shareholders to make proposals for inclusion in such proxy materials related to executive compensation.

Additionally, H.R. 1257 would require that, in any proxy solicitation material for an annual or other shareholders meeting occurring on or after January 1, 2009, that concerns an acquisition, merger, consolidation, or proposed sale or other disposition of substantially all the assets of an issuer (i.e. a public company), the person making such solicitation disclose in the proxy solicitation material (in a "clear and simple form," as determined by SEC regulations) any agreements that such person has with any of the company's (or the acquiring company's) principal executive officers regarding any compensation (whether present, deferred, or contingent) that relates to the acquisition, merger, consolidation, sale, or other disposition, and that has not been subject to a shareholder vote above. [Such compensation is commonly known as "golden parachute" compensation.]

The proxy solicitation material containing the golden parachute compensation disclosure would have to require a separate shareholder vote to approve such compensation. As above, this shareholder vote would not be binding on the board of directors and could not be construed as overruling a decision by such board, or as creating or implying any additional fiduciary duty by the board. Furthermore, this vote could not be construed as restricting or limiting the ability of shareholders to make proposals for inclusion in such proxy materials related to executive compensation.

The SEC would be required to issue final regulations regarding these provisions above within one year of the enactment of this legislation.

Additional Background: According to the Business Roundtable, many companies have voluntarily shifted to a system of majority voting for members of boards of directors. Currently 52% of the S&P 500 have adopted some form of majority voting, up from 20% last year. Additionally, the results of a 2006 Business Roundtable corporate governance survey of its members reported that 85% of its company boards are composed of at least 80% independent directors (i.e. directors with no business, employment, charitable, or personal relationship with the company or its management).

http://www.house.gov/apps/list/hearing/financialsvcs_dem/htcastellani030807.pdf.

RSC Bonus Fact: The Bureau of Economic Analysis released data last year showing that the average annual compensation (wages plus benefits) for federal civilian workers in 2005 was \$106,579—twice the average compensation paid in the U.S. private sector: \$53,289. Excluding benefits, the average federal civilian worker earned \$71,114 in 2005, 62% more than the average private-sector worker, who made \$43,917. Since 1990, average compensation for federal workers has increased by 129%, according to the Bureau of Economic Analysis, compared to

74% for private-sector workers over the same timeframe.

http://www.cato.org/pub_display.php?pub_id=6611.

Committee Action: On March 1, 2007, the bill was referred to the Financial Services Committee. On March 21st and 28th, the committee marked up the bill and, on the 28th, ordered it reported to the full House by a vote of 37-29.

Possible Conservative Concerns: Some conservatives may regard this legislation as a federal intrusion into business matters that are currently governed by the states. That is, company organization and structure is governed by state law, while federal securities laws generally govern the disclosure of information to investors.

Some conservatives may believe that, since corporations are private entities designed to generate value for their shareholders, it is not the federal government's proper role to intervene and tell such corporations when their shareholders can vote on issues and when they can not (regardless of whether such vote is binding). Private-market pressures should determine (and have determined) whether executive compensation is too high or too low. Some public companies (such as Aflac) have voluntarily implemented nonbinding shareholder voting on executive compensation, but many conservatives believe that taking such steps should not be dictated by the federal government.

http://www.house.gov/apps/list/hearing/financialsvcs_dem/osneugebauer030807.pdf.

Further, some conservatives may believe that the issue of executive compensation is best handled by boards of directors. Shareholders elect the directors and otherwise participate in other significant actions (like approving mergers), but they do not run the operations of companies.

Additionally, some conservatives may believe that this legislation could lead to a slippery slope of demands for shareholder votes on other significant corporate matters normally reserved for boards of directors, such as marketing plans and capital investments.

Administration Position: A Statement of Administration Policy (SAP) is forthcoming but was not available at presstime.

Cost to Taxpayers: CBO estimates that "implementing H.R. 1257 would cost about \$1 million in 2008 to develop regulations, and less than \$500,000 per year thereafter to review and monitor compliance by companies affected by the regulations."

Does the Bill Expand the Size and Scope of the Federal Government?: Yes. This bill includes a federal intrusion into private-sector business matters that are currently governed by the states.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: Yes, the bill contains two private-sector mandates requiring shareholder voting. CBO notes, however, that "the cost to comply with those mandates would fall below the annual threshold established by UMRA (\$131 million in 2007, adjusted annually for inflation)."

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: The Financial Services Committee, in House Report [110-88](#), asserts that, “H.R. 1257 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.”

Constitutional Authority: The Financial Services Committee, in House Report [110-88](#), cites constitutional authority in Article I, Section 8, Clause 1 (relating to the general welfare of the United States) and Clause 3 (relating to the power to regulate interstate commerce).

Outside Organizations: The American Federation of State, County, and Municipal Employees (AFSCME), the largest union within the AFL-CIO, is supporting this legislation. http://www.house.gov/apps/list/hearing/financialsvcs_dem/htferlauto030807.pdf.

The Business Roundtable is opposing this legislation. Before the Financial Services Committee, the Roundtable’s President, John Castellani, offered the following assessment, among others: “Business Roundtable believes that the best people to set executive compensation and hold CEOs accountable for company performance are the independent members of a company’s board of directors, acting upon the recommendations of their compensation committees. These committees are subject to strict independence requirements, and all directors are strictly accountable to all shareholders.” Further, the Roundtable notes: “Unlike democracies, shareholder rights vary based upon the size of their investment, and by definition corporate decision making is not a democratic process.”

The Roundtable also argues that “requiring a shareholder vote on compensation – even an advisory vote – would seriously erode critical board responsibility. Determining compensation involves several factors: company goals, specific performance metrics, and amounts negotiated under the terms of an employment contract. It would be difficult to effectively subject some or all of these elements to a voting process.”

http://www.house.gov/apps/list/hearing/financialsvcs_dem/htcastellani030807.pdf.

The *Wall Street Journal* (“How Borrowed Shares Swing Company Votes”), on January 26, 2007, reported on extensive problems with shareholder proxy voting, especially in regards to private investment funds borrowing shares of public companies and swing vote outcomes.

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